RESPs for Adults

Robert MacKenzie

Recent changes to the rules of Registered Educational Savings Plan (RESPs) have opened up new possibilities for financial planning, and not just for kids.

The most attractive feature of an RESP for a child is straightforward – put some money for education in and the government adds to it and/or shelters the plan's income. Other aspects are more complex. If you missed making deposits in some years in a child's life, even before you started the plan, you can catch up one extra year at a time. There is a limit on the number of years you can make contributions, there are restrictions with respect to withdrawals, and different rules apply depending on who the contributor is and how beneficiaries and contributors are related.

As well as attracting a generous government grant, the RESP features tax-saving advantages. For one thing, although deposits do not create an immediate tax benefit, it is the child and not the parent or other contributor who will be the one ultimately reporting the plan's growth and grant income at their lower tax rate. And like an RRSP, an RESP's growth and/or grant income is sheltered from tax as long as it is inside the plan, which could be 17 years or more in many cases.

Formerly, $2,000 of a possible $4,000 deposited into the plan every year attracted a 20% or $400 grant per child. The new rules allow for $2,500 to be deposited every year for a 20% or $500 grant, and even more grant money is available to families with a net income less than $74,000. However, the potential lifetime amount of grant money available remains at $7,200, meaning that the benefit is only that the grant money is deposited in the plan more quickly than it would have been under the former rules, thus benefiting from tax sheltering for a little while longer. Although it looks as if there is more cash being offered, there is, in fact, no increased benefit in the total amount of grant money. (Should we be surprised?)

Another major change allows for an annual deposit up to a new $50,000 maximum allowed over the life of the plan, increased from $42,000. Its value is mainly that a much greater amount of money can be sheltered within the RESP for a longer period. Yet there is again no overall direct cash benefit.

If desired, full sheltering can begin immediately so that compounding can work its magic. There is a downside, however. If, for example, the full $50,000 is deposited upon the birth of a child, $45,000 at the end of December and $5,000 at the beginning of January so as to obtain two years of grant money, only those two years' worth of grants will ever be received. That's $1,000, or 2% of the total maximum of $50,000 invested. It's much less than the $7,200, or 20% that would result if 14 years of $2,500 deposits and one year's of $1,000 totalling $36,000 were made.

Which option is best? Should a large lump sum be deposited and left to compound tax-free until withdrawal or should grant money be garnered to the fullest? Various columnists have "run the numbers" (I found Jamie Golombeck's *National Post* column on RESP changes at Canada.com) and I won't do that here to the same extent. Suffice it to say most commentators have concluded that simply making a lump sum of $50,000 deposit is not significantly more advantageous than other strategies that employ a "hybrid" approach to contributing, which combines both lump sum and periodic contributions.

I must say that I prefer the idea of obtaining a guaranteed gain on investments, as represented by the "free" money provided by the government. Relying solely on uncertain investment gains, as would be required if a single large deposit were made, is riskier than taking advantage of the certainty of the government benefit. Fortunately, one can combine a lump sum and a gradual strategy to minimize risk without reducing the gain very much. With that in mind, here are a few principles that underlie such a hybrid approach to RESP contributions.

1 If you have it available, you could immediately put $14,000 into your plan. This is the amount in excess of the $36,000 needed for obtaining the maximum $7,200 grant over 15 years of contributions. You won't get a grant for this money, so why not shelter it and gain that way? Should you already have a plan underway, you can do some

math by adding past and future deposits to figure out how much room you have left for a lump sum deposit. Putting in a large lump sum early would be particularly helpful for those who plan to invest in bonds or other interest-bearing vehicles inside their RESP, since if they were held outside of their plan the interest income would be taxed away at a high rate every year.

2 If you have it available, you could immediately put the $36,000 designated for generating grant money in future years into an equity mutual fund account or stock portfolio outside of the RESP. A fund or portfolio that invests in equities and produces primarily capital gains income is a partial form of sheltering, since their income is chiefly taxed only when the equities are sold and then at a lower rate. Every year you would transfer the $2,500 needed to obtain the grant money into your RESP. An added benefit is that your money (to avoid possible legal problems, the fund should be in your name and not the child's because you are the RESP's owner) is not subject to RESP withdrawal rules when it is invested outside of the plan.

3 If you don't have lump sums at hand, an annual deposit of $3,333 instead of just the basic $2,500 over 15 years would generate the grant money and also supply the extra cash to reach the $50,000 maximum. If your plan is already underway, you would have to calculate this figure yourself to fit your own situation.

The $50,000 in deposits and grant money will double or triple after 17 years or so with a 6% average annual return. If this amount seems excessive just for educational purposes, it should be remembered that no receipts are required for the educational expenses, only proof of registration in a post-secondary programme. Any excess money that is withdrawn can be used for other purposes after the child has paid tax on the grant and growth portions. Making sure that the grant and growth, rather than the tax-free capital portion, are withdrawn first (you have the choice) reduces risk from the student not staying long in their post-secondary programme and forfeiting these benefits. Your capital deposits come out tax-free.

As helpful as it is to get free grant money for kids from an RESP, they are not without value for those over 18. Adults can set them up for themselves and take advantage of educational opportunities in later life. While there is no grant money to be had, the tax-sheltering of a plan's income can help to pay tuition costs for Mom and Dad as well.

How would this work? One possibility is that someone who plans to take a sabbatical study period or to study early in retirement in 5 years time can put a lump sum of $50,000 into an adult RESP. So, as not to risk the money not being there when it is needed, it is invested in GICs at 5%. That will have produced $13,800 in income by the time school starts. Only $5,000 of this amount can be used for the first term, but there is no restriction on withdrawals of growth money in succeeding terms. Presumably the person would have little earned income that year and so the income tax on the withdrawn money would be minimal. Tuition and attendance tax credits would also be available.

Rather than saving up for the education opportunity outside of the plan and losing about $4,000 of the $13,800 to the taxman in annual taxation of the interest income when income is high, the adult RESP can shelter it and disburse it when the income and annual tax rate is low. Some universities offer study-travel terms in the major cultural centres of Europe or elsewhere that might be of interest. Why should college grads touring the continent have all the fun? And if only a limited time is available, the new rules allow for part-time studies of 12 hours per month to be covered with $2,500 in income withdrawals. Welding, anyone? You could even ask your grown children to pay part of the cost of your new educational savings plan. After all, fair is fair!

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Dale's note: Bob advises readers to shop for an RESP, particularly when it comes to choosing between "pooled" or "scholarship" plans. Unfortunately, detailed information on scholarship plans usually can only be obtained from a salesperson, so be prepared to exercise sales resistance!

In general, a pooled plan is more restrictive than a self-directed RESP set up with a mutual fund company or broker and may have significant commission costs that are effectively non-refundable for the first few years of the plan's existence.

Self-directed plans can have a no-load or 0% front-end commission option, but run the risk of losing money if the investments held in it are not solid, conservative choices.

RESP Explained

For further information on RESPs, please visit www.investored.ca/en/investoranswers/Pages/topic-resp.aspx. Some of the topics covered are:

- How do Registered Education Savings Plans (RESPs) work?
- How much do Registered Education Savings Plans (RESPs) pay?
- How do I open a Registered Education Savings Plan (RESP)?
- How do I save for my child's/grandchild's education?